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Option 2

*Whether to substitute “earnings before taxes” and “net income” in place of “financial criteria for listing” where the regulation currently ranks the size of business entities and corresponding material financial effect according to whether the business entity is listed, or meets the financial criteria for listing, on either the New York Stock Exchange, the American Stock Exchange or NASDAQ. **Option 2(a)** states specific dollar thresholds of earnings before taxes and net income. **Option 2(b)** provides an election to use either specific dollar thresholds of earnings before taxes and net income, or the dollar threshold of the corresponding exchange, on a current basis. Language depicting these options is shown below by use of shaded text.*

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Amend 2 Cal. Code Regs. Section 18705.1 as follows:

18705.1. Materiality Standard: Economic Interests in Business Entities.

(a) Introduction.

(1) If a business entity in which a public official has an economic interest is directly involved in a governmental decision (see 2 Cal. Code Regs., section 18704.1(a)), use the standards in subdivision (b) of this regulation.

(2) If a business entity in which a public official has an economic interest is indirectly involved in a governmental decision (see 2 Cal. Code Regs., section 18704.1(b)), use the standards in subdivision (c) of this regulation.

(b) Directly involved business entities.

(1) General Rule: Unless the exception in subdivision (b)(2) of this regulation applies, the financial effects of a governmental decision on a business entity which is

1 directly involved in the governmental decision is presumed to be material. This
2 presumption may be rebutted by proof that it is not reasonably foreseeable that the
3 governmental decision will have any financial effect on the business entity.

4 (2) Exception: If the public official's only economic interest in the business entity
5 is an investment interest (see Government Code section 87103(a)), and the public
6 official's investment in the business entity is worth \$25,000 or less, then apply the
7 materiality standards in subdivision (c)(1) of this regulation if the business entity is listed
8 on the Fortune 500, or the materiality standards in subdivision (c)(2) of this regulation if
9 the business entity is listed ~~, or meets the financial criteria for listing,~~ on the New York
10 Stock Exchange [**Option 2(a):**] [, or if not listed on the New York Stock Exchange, for
11 its most recent fiscal year had earnings before taxes of no less than \$2.5 million.]
12 [**Option 2(b):**] [, or if not listed on the New York Stock Exchange, for its most recent
13 fiscal year had earnings before taxes of no less than:

14 (A) \$2.5 million, or
15 (B) such other amount described at Rule 102.01C of the New York Stock
16 Exchange's Listed Company Manual (or any superseding rule of the New York Stock
17 Exchange describing its financial standards for initial listing).]

18 [**Option 2(c):**] [.]

19 (c) Indirectly involved business entities. The following materiality standards
20 apply when a business entity in which a public official has an economic interest is
21 indirectly involved in a governmental decision. If more than one of the following
22 subdivisions is applicable to the business entity in question, apply the subdivision with
23 the highest dollar thresholds.

(1) If the business entity is listed in the Fortune 500, the financial effect of a governmental decision on the business entity is material if it is reasonably foreseeable that:

(A) The governmental decision will result in an increase or decrease in the business entity's gross revenues for a fiscal year of \$10,000,000 or more; or

(B) The governmental decision will result in the business entity incurring or avoiding additional expenses or reducing or eliminating existing expenses for a fiscal year in the amount of \$2,500,000 or more; or

(C) The governmental decision will result in an increase or decrease in the value of the business entity's assets or liabilities of \$10,000,000 or more.

(2) If the business entity is listed, ~~or meets the financial criteria for listing,~~ on the New York Stock Exchange

[Option 2(a):] [, or if not listed on the New York Stock Exchange, for its most recent fiscal year had earnings before taxes of no less than \$2.5 million,]

[Option 2(b):] [, or if not listed on the New York Stock Exchange, for its most recent fiscal year had earnings before taxes of no less than \$2.5 million, or such other amount described at Rule 102.01C of the New York Stock Exchange's Listed Company Manual (or any superseding rule of the New York Stock Exchange describing its financial standards for initial listing),]

the financial effect of a governmental decision on the business entity is material if it is reasonably foreseeable that:

(A) The governmental decision will result in an increase or decrease to the business entity's gross revenues for a fiscal year in the amount of \$500,000 or more; or,

1 (B) The governmental decision will result in the business entity incurring or
2 avoiding additional expenses or reducing or eliminating existing expenses for a fiscal
3 year in the amount of \$200,000 or more; or,

4 (C) The governmental decision will result in an increase or decrease in the value
5 of assets or liabilities of \$500,000 or more.

6 (3) If the business entity is listed ~~, or meets the financial criteria for listing,~~ on
7 either the NASDAQ ~~/AMEX~~ or American Stock Exchange, [or if not so listed, for its
8 most recent fiscal year had:

9 **[Option 2(a):]** [net income of no less than \$500,000, or earnings before taxes of no less
10 than \$750,000,]

11 **[Option 2(b):]** [net income of no less than \$500,000 (or such other amount described in
12 the minimum financial requirements for continued listing on the NASDAQ SmallCap
13 market), or earnings before taxes of no less than \$750,000 (or such other amount of
14 earnings before taxes described under initial listing standard 1 of Section 101(a) of the
15 Rules of the American Stock Exchange, or any superseding Section of the Rules of that
16 Exchange),]

17 the financial effect of a governmental decision on the business entity is material if it is
18 reasonably foreseeable that:

19 (A) The governmental decision will result in an increase or decrease to the
20 business entity's gross revenues for a fiscal year in the amount of \$300,000 or more; or,

21 (B) The governmental decision will result in the business entity incurring or
22 avoiding additional expenses or reducing or eliminating existing expenses for a fiscal
23 year in the amount of \$100,000 or more; or,

1 (C) The governmental decision will result in an increase or decrease in the value
2 of assets or liabilities of \$300,000 or more.

3 (4) If the business entity is not covered by subdivisions (c)(1)-(3), the financial
4 effect of a governmental decision on the business entity is material if it is reasonably
5 foreseeable that:

6 (A) The governmental decision will result in an increase or decrease in the
7 business entity's gross revenues for a fiscal year in the amount of \$20,000 or more; or,

8 (B) The governmental decision will result in the business entity incurring or
9 avoiding additional expenses or reducing or eliminating existing expenses for a fiscal
10 year in the amount of \$5,000 or more; or,

11 (C) The governmental decision will result in an increase or decrease in the value
12 of the business entity's assets or liabilities of \$20,000 or more.

13 (d) Terminology. The accounting terms described below are the same as, or not
14 inconsistent with, terms used in Generally Accepted Accounting Principles and Generally
15 Accepted Auditing Standards. Nothing in this subdivision should be construed to
16 incorporate new items not contemplated under Generally Accepted Accounting Principles
17 and Generally Accepted Auditing Standards, nor to exclude any items that might be
18 included in the definitions of these terms under Generally Accepted Accounting
19 Principles and Generally Accepted Auditing Standards.

20 (1) Assets. As used in this section, "assets" means all property, real and personal,
21 tangible and intangible, which belongs to any business entity. This includes, but is not
22 limited to, cash, securities, merchandise, raw materials, finished goods, operating
23 supplies, and ordinary maintenance material and parts, accounts receivable and notes and

1 loans receivable, and prepaid expenses (such as prepaid insurance, interests, rents, taxes,
2 advertising, and operating supplies).

3 (A) When a business entity holds a claim over collateral (including real property)
4 as security for a loan made by the business entity, such a claim does not make the
5 collateral (including real property) an "asset" of the business entity, unless the business
6 entity has initiated proceedings to foreclose upon, or acquire the asset based on the
7 debtor's failure to repay the loan. The loan or note secured by the collateral is an asset.

8 (B) The definition of "assets" also includes intangible assets. Intangible assets,
9 include, but are not limited to, long-lived legal rights and competitive advantages
10 developed or acquired by a business enterprise, patents, copyrights, franchises,
11 trademarks, organizational costs, goodwill, and secret processes.

12 (2) Earnings Before Taxes: Revenue, less the cost of goods sold and selling,
13 general, and administrative expenses (but not excluding depreciation and amortization
14 expenses); otherwise defined as operating and non-operating profit before the deduction
15 of income taxes. Described variously as EBT, Income Before Income Taxes, or Income
16 Before Provision for Income Taxes.

17 ~~(2)~~ (3) Expenses: In general, the term refers to the current costs of carrying on an
18 activity.

19 ~~(3)~~ (4) Gross Revenue: Actual or expected inflows of cash or other assets. "Gross
20 Revenue" is the revenue of a business entity before adjustments or deductions are made
21 for returns and allowances and the costs of goods sold, and prior to any deduction for
22 these and any other expenses.

1 ~~(4)~~ (5) Liabilities: Obligations of the business entity, liquidation of which is
2 reasonably expected to require the transfer of assets or the creation of other new
3 liabilities. Any financial obligation or cash expenditures that must be made by the
4 business entity at a specific time to satisfy the contractual terms of such an obligation.

5 (6) Net Income: A business entity's total earnings; otherwise defined as revenues
6 adjusted for the costs of doing business, depreciation, interest, taxes, and other expenses.
7 This amount is usually found at the bottom of a business entity's Profit and Loss
8 statement. Also described as Net Profit.

9 (e) Financial statements. In complying with this regulation, public officials may
10 rely on the most recent independently audited financial statements of the business entity
11 so long as those statements are reflective of the current condition of the business entity.
12 Financial statements are not considered "reflective of the current condition of the
13 business entity" where:

14 (1) The most recent independently audited financial statements of the business
15 entity are for a fiscal year ending more than twenty-four months prior to the date of the
16 governmental decision.

17 (2) The most recent audit of the financial statements resulted in an adverse
18 opinion, was issued with a disclaimer, or was otherwise qualified in such a manner that
19 the statement of assets, liabilities, expenses, or gross revenues is questioned in the audit
20 report, or

21 (3) There has been a subsequent event, intervening between the date that the
22 financial statement was created and the date of the decision of the public official, that
23 makes the statement no longer representative, including, but not limited to, business

1 reorganizations.

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3 NOTE: Authority cited: Section 83112, Government Code.

4 Reference: Sections 87100, 87102.5, 87102.6, 87102.8 and 87103, Government Code.

5 COMMENTS: Electronic access to annual reports, quarterly reports, and other financial
6 statements filed with the United States Securities and Exchange Commission (“SEC”)
7 may be obtained by accessing the SEC’s website and selecting its EDGAR database of
8 statutory filings: <http://www.sec.gov/edgar/searchedgar/companysearch.html>.

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10 **[Option b: The earnings before taxes and net income criteria for listing on the New York**
11 **and American Stock Exchanges, and NASDAQ may be obtained through links from the**
12 **following webpages:**

13 New York Stock Exchange: <http://www.nyse.com/listed/listed.html>.

14 American Stock Exchange: <http://wallstreet.cch.com/AmericanStockExchangeAMEX/>.

15 NASDAQ: http://www.nasdaq.com/about/nasdaq_listing_req_fees.pdf.]
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